SHAWNEE PRODUCTS, INC.,	:	Order Affirming Decision
Appellant	:	
	:	
v.	:	
	:	Docket No. IBIA 97-78-A
ACTING ANADARKO AREA DIRECTOR,	:	
BUREAU OF INDIAN AFFAIRS,	:	
Appellee	:	January 9, 1998

This is an appeal from a November 14, 1996, decision of the Acting Anadarko Area Director, Bureau of Indian Affairs (Area Director; BIA), disapproving a request for a loan guaranty. For the reasons discussed below, the Board affirms the Area Director's decision.

In its notice of appeal, Appellant states that it "is a tribal enterprise organized under the laws of and * * * wholly owned by the Absentee Shawnee Tribe of Indians of Oklahoma [(Tribe)]." Notice of Appeal at 1. 1/ Appellant further states that it "is a manufacturer and supplier of various types of medical soft goods to include: first aid kits, survival kits, compressed bandages, and field dressing." Id.

In July 1996, Appellant submitted an application for a 90% guaranty of a loan in the amount of $700,000. Appellant's application indicated that it planned to use $100,000 of the loan proceeds to purchase new equipment and $600,000 to retire certain debts. The application was reviewed initially at the Anadarko Agency, BIA. It was then sent by the Agency to the Director, Office of Economic Development (OED), in BIA's Central Office in Washington, D.C. On October 4, 1996, the Director, OED, sent the application to the Area Director, stating: "We cannot respond to this request until we have received an Area Office credit memorandum indicating an independent analysis and the Area Director's recommendation for approval of the request." Although declining to review the application in depth, the Director, OED, noted some concerns with it, including a concern that the application showed Appellant to have a negative net worth.

Appellant's application was then reviewed at the Anadarko Area Office. Appellant was given an opportunity to respond to certain concerns and did so on October 18, 1996. On November 14, 1996, the Area Director disapproved Appellant's application, concluding: "[T]he Borrower fails to provide a

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1/ In its Expansion Business Plan, submitted to BIA with its loan guaranty application, Appellant stated that it "is wholly-owned by the Absentee Shawnee Tribal Development Authority [(ASTDA)], a political subdivision of the [Tribe.]" Expansion Business Plan at 1.

clear source of repayment ability or inadequate [sic] cash flow to service the debt, insufficient assets to secure the request (Which is not grounds for disapproval), lacks the 20% equity contribution, and insufficient updated information." Area Director's Decision at 4.

On appeal to the Board, Appellant attacks all of the Area Director's reasons for disapproving its application. Under the circumstances of this case, the Board finds it necessary to address only one of the reasons given by the Area Director, i.e., lack of a 20 percent equity contribution, because it concludes that the Area Director's decision must be affirmed on the basis of that reason alone.

The BIA's loan guaranty program is governed by regulations in 25 C.F.R. Part 103. Subsection 103.10 provides: "The following loans are not eligible for guaranty or insurance under this part 103: * * * (f) Loans to a borrower whose equity, as defined in § 103.1, in the business being financed is less than 20 percent." Section 103.1 defines "equity" as "the borrower's residual ownership, after deducting all business debt, of tangible business assets used in the business being financed, on which a lender can perfect a first lien position."

In its Expansion Business Plan, Appellant stated: "[Appellant's] costs to expand and refinance debt will total $840,000. 20% of the total costs will be met with cash and in kind capital contributions totalling at least $140,000." Expansion Business Plan at 26.

In its October 18, 1996, Responses to BIA Concerns, Appellant stated:

Concern:

Company Capital Contribution - The Company (Tribe) needs to contribute $140,000 (20% of planned $700,000 debt). The contribution was not clearly seen in the financial statements and application.

Response:

The $140,000 contribution will be met as follows:

Cash to be paid down on new packaging machine	$ 20,000
Use of building rent free for 2 years	100,000
Debt forgiven by ASTDA at [sic] March 31, 1996	20,000
	$ 140,000

Responses to BIA Concerns at 3.

It appears that both Appellant and BIA considered $140,000 to be the amount Appellant was required to contribute in equity. $140,000 is 20 percent of $700,000, the amount of the loan for which Appellant sought a guaranty, rather than 20 percent of Appellant's total costs to expand and

refinance debt ($840,000), as stated in Appellant's Expansion Business Plan. 2/

As indicated above, 25 C.F.R. § 103.10(f) requires a loan guaranty applicant to have at least 20 percent equity "in the business being financed." The scope of the term "the business being financed," and thus the base upon which the 20 percent equity contribution is to be calculated, is not entirely clear from the language of the provision itself. The Board therefore turns for possible guidance to the corresponding provision in 25 C.F.R. Part 101, governing direct loans. Subsection 101.3(a) provides: "[T]he applicant will be required to have equity equal to 20 percent of the total cost of a new enterprise, or 20 percent of the total cost of expansion of an existing enterprise."

The 20 percent equity requirement was added to Parts 101 and 103 at the same time. Even though the language of the two provisions is different, the preambles to the proposed and final rules suggest that they were intended to mean the same thing. The preamble to the proposed rules stated: "A requirement that borrowers must provide at least 20 percent equity in the business being financed with a direct or guaranteed loan is added." 56 Fed. Reg. 48,082 (Sept. 23, 1991). As published, however, the proposed rules included a 20 percent equity requirement only in Part 101. The preamble to the final rules stated: "The Supplementary Information part of the preamble to the proposed rule points out that the requirement for 20 percent equity applies to both direct and guaranteed loans. This proposed requirement was inadvertently left out of part 103, the rule for guaranteed loans. We are putting the equity requirement in § 103.10 of that part." 57 Fed. Reg. 46,470 (Oct. 8, 1992). The preamble to the final rules also repeated language from the preamble to the proposed rules: "A requirement that borrowers must provide at least 20 percent equity in the business being financed with a direct or guaranteed loan is added." 57 Fed. Reg. at 46,471. Thus, in both preambles, BIA equated the phrase "20 percent equity in the business being financed" to the more detailed provisions of 25 C.F.R. § 101.3(a). The Board concludes that "20 percent equity in the business being financed" was almost certainly intended to mean the same thing as "equity equal to 20 percent of the total cost of a new enterprise, or 20 percent of the total cost of expansion of an existing enterprise."

As noted above, Appellant stated in its Expansion Business Plan that its "costs to expand and refinance debt will total $840,000." If it is assumed that this amount, although including debt refinancing, is equivalent to the "total cost of expansion of an existing enterprise," it appears that Appellant should have been required to contribute $168,000 in equity, rather than $140,000. 3/ If this assumption is correct, BIA erred to the benefit of Appellant by requiring it to contribute the lower amount.

2/ Twenty percent of $840,000 is $168,000.

3/ It is perhaps conceivable that the "total cost of expansion of an existing enterprise" in this case was only $120,000 (the cost of the new equipment Appellant sought to purchase), because only that equipment would have been used to "expand" the business. Under this interpretation, the $600,000 Appellant sought for debt refinancing, representing the bulk of

Because the parties have not addressed this point but instead have proceeded on the premise that only $140,000 in equity was required, the Board assumes, but does not decide, that Appellant was required to contribute only that amount.

Of the three assets Appellant proposed as equity, the Area Director recognized only asset 1 ($20,000 cash to be paid on new equipment) as acceptable. With respect to asset 2 (use of a building), he stated: "The building, owned by the [Tribe], appraised at $50,000 per year x 2 years = $100,000, cannot be used as equity by [Appellant] to satisfy the 20% contribution requirement. This building is an asset of the Tribe." Area Director's Decision at 3. With respect to asset 3 (a forgiven debt), he stated: "The Tribe's forgiveness of $20,000 does not become equity for a loan and cannot be utilized to benefit [Appellant's] loan requirements." Id.

On appeal to the Board, Appellant argues that the Area Director should have considered assets 2 and 3 as equity. With respect to asset 2, it contends:

> [T]he Tribe has agreed to allow the appellant the free use of the building for two years. The free use of the building is tantamount to an equity contribution to the business, for the Tribe has agreed to forego market rents on the building to facilitate the financing requested in the Loan Package.

Notice of Appeal at 3-4. In support of this contention, Appellant submits a December 5, 1996, letter from a certified public accountant, which states:

> In accordance with generally accepted accounting principles, the [$100,000] credit to contributed capital is considered equity as the Tribe has contributed an asset in the way of prepaid rent to [Appellant]. This amount is considered an asset because the Tribe is giving up future income that they would have received from [Appellant], and [Appellant] is booking it as an asset because in reality they will not have to pay rent for the next 2 years. This is equivalent to a cash injection by the Tribe to [Appellant].

Exhibit 7 to Notice of Appeal.

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fn. 3 (continued)
its requested loan guaranty, would be disregarded.

The purpose of the 20 percent equity requirement was discussed in the preamble to the final rules:

"Experience has proven that debt financing approaching 100 percent drastically increases the likelihood of loan default. Most private banks require at least 30 percent equity to support loan repayment. Less than a 20 percent equity requirement is believed to be insufficient to ensure the repayment standard required by the Indian Financing Act."
57 Fed. Reg. at 46,470.

Given this purpose, the Board declines to interpret the 20 percent equity requirement as inapplicable to the $600,000 Appellant sought for debt refinancing.

With respect to asset 3, Appellant contends:

> By all accounting principles applicable to business and even IRS rules which apply to taxable entities, the forgiveness of debt translates into income for the party being forgiven. The income from the debt forgiveness flows into the equity account of the business. The $20,000 was treated as such by the appellant's accounting firm in its audit conducted for the year ending March 31, 1996.

Notice of Appeal at 4.

Whether or not assets 2 and 3 are "equity" under general accounting principles is of peripheral relevance here. The question here is whether they qualify as "equity" under the definition in 25 C.F.R. § 103.1, i.e., whether they are part of "the borrower's residual ownership, after deducting all business debt, of tangible business assets used in the business being financed, on which a lender can perfect a first lien position." Appellant fails to relate its general discussion of "equity" to the definition in section 103.1. In particular, Appellant fails to explain how either asset 2 or 3 qualifies as a tangible business asset upon which a lender can perfect a first lien position.

The Board sees no way in which a lender could perfect a first lien on the forgiven debt.

It is perhaps conceivable that a lender could perfect a first lien on the "prepaid rent," although the manner in which this might be accomplished is not immediately apparent, especially if the building is located on trust land. It was Appellant's task to show how this asset qualifies as equity under 25 C.F.R. § 103.1. See, e.g., River Bottom Cattle Co. v. Acting Aberdeen Area Director, 25 IBIA 110, 113 (1994), and cases cited therein. (An appellant bears the burden of proving error in a BIA decision denying a loan guaranty request.) By failing even to mention the critical part of the regulatory definition, let alone attempt to show how the asset qualifies under it, Appellant has failed to carry its burden of proof in this regard.

In any event, even if the "prepaid rent" could qualify as equity under 25 C.F.R. § 103.1, Appellant would still be $20,000 short of the $140,000 in equity it was required to contribute.

The Board finds that Appellant has failed to show error in the Area Director's conclusion that it lacked the required 20 percent equity contribution. Under 25 C.F.R. § 103.10(f), a loan to a borrower whose equity is less than 20 percent is not eligible for a BIA loan guaranty.

Therefore, pursuant to the authority delegated to the Board of Indian Appeals by the Secretary of the Interior, 43 C.F.R. § 4.1, the Area Director's November 14, 1996, decision is affirmed.

Anita Vogt	Kathryn A. Lynn
Administrative Judge	Chief Administrative Judge